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No. 94-747

In The

Supreme Court of the United States

October Term, 1994

EVA M. HUBER,

Petitioner,

v.

CURTIS B. DANNING, TRUSTEE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent respectfully prays that the Court deny the Petition for Writ of Certiorari (the "Petition") brought by petitioner Eva M. Huber ("Huber") requesting that this Court review the unpublished decision of the United States Court of Appeals for the Ninth Circuit.

STATUTES INVOLVED

The Trustee refers to 11 U.S.C.A. §§ 541(a)(1)-(4) and (d), 544(a), 550(a) and 551 (1994); 11 U.S.C.A. § 541(d)

(1978); and Cal. Civ. Code § 2950 (West 1994), each of which is attached in full as an Appendix hereto.

I.

STATEMENT OF THE CASE

A. Introduction.

Respondent Curtis B. Danning, the Chapter 7 trustee (the "Trustee") for the estate of Lance E. Thomas (the "debtor"), is defending a summary judgment he obtained against petitioner Eva M. Huber ("Huber"). That summary judgment (the "judgment") held that since the Trustee has, under section 544(a)(3),[1] the rights and privileges of a *bona fide* purchaser for value under California law without actual knowledge of any adverse claim by Huber, the estate took a parcel of real property commonly known as 2861 Club Drive, Los Angeles, California (the "Club Drive property") free and clear of Huber's alleged interest. The bankruptcy court also found that there were no facts which would impart constructive notice of her claim to a *bona fide* purchaser. The summary judgment was affirmed by both the Bankruptcy Appellate Panel for the Ninth Circuit (the "Panel") and the United States Court of Appeals for the Ninth Circuit.

This brief will focus on the interest which Huber seeks to assert. The underlying adversary proceeding was originally commenced by Huber, among other things, to impose a constructive trust on proceeds of the Club Drive

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[1] All references herein to sections refer to Title 11 of the United States Code.

property held by the Trustee. In essence, Huber contended that the debtor induced her to duly execute and deliver a grant deed instead of a deed of trust to secure various debts owed by her to the debtor. Through the underlying adversary proceeding, Huber requested, *inter alia*, that the court grant her the equitable remedy of reforming the grant deed at issue, turning it into a deed of trust.

One of the three fundamental flaws in her argument is Huber's assertion that section 541(d) excludes from property of the estate the sort of equitable interest she claims. The statute itself contradicts her position, and the cases which she cites as allegedly being in conflict with that of the Ninth Circuit are distinguishable.

Huber's second fundamental flaw is the requirement under California law that one claiming constructive notice prove, in addition to open and notorious use, her *exclusive* occupancy of the property. This Huber could not do because she admits that the debtor also resided on the Club Drive property when he filed his bankruptcy petition.

The third fundamental flaw is that the evidence to which Huber drew the lower courts' attention does not import constructive notice that the grant deed she executed and tendered to the debtor should have been a deed of trust. The only facts cited by Huber thereof are: (1) the existence of locks on three bedroom doors in the Club Drive property, which was and remains a single family, residential home; and (2) the self-serving statements of Huber's relatives who resided at the time on the Club Drive property with the debtor and Huber that they

believed that Huber owned the property. None of these facts in any way would suggest to anyone that the grant deed was intended to be a deed of trust.

As a result, the bankruptcy court's ruling and the appellate court affirmances were proper, and the Petition should be denied.

B. Underlying Events.

Before bankruptcy, on August 1, 1988, Huber executed a grant deed with respect to the Club Drive property in favor of the debtor (the "subject deed"). Record[2] at 55. Huber had the subject deed duly notarized, and delivered that deed to the debtor. Record at 55, 77. Bankruptcy occurred on *November 21, 1988*. Record at 44. On January 25, 1989 – *after* the debtor's bankruptcy filing – the debtor recorded the subject deed. Record at 55.

On or about August 10, 1988, the debtor duly executed a grant deed with respect to the Club Drive property in favor of Howard Gunderson ("Gunderson"). Record at 3. Although that deed was never recorded, the debtor duly executed another grant deed to Gunderson on January 25, 1989 [post-petition], which was recorded on January 27, 1989. Record at 3, 56. These two deeds collectively shall be referred to hereinafter as the "Gunderson Deeds."

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[2] Because the Trustee did not receive a designated record from Huber in support of the Petition, all references to the "Record" are to Huber's record before the Ninth Circuit Court of Appeals.

The Club Drive property is and at all relevant times herein was a single family, residential dwelling with a guest house in the back. Record at 331. On the date of bankruptcy, the debtor resided at the Club Drive property with Huber, her two daughters and her mother. Record at 250. Between the time of the execution of the subject deed and the bankruptcy filing date, Huber and the debtor were engaged in an extra-marital relationship. Record at 249.

C. Bankruptcy History.

On November 21, 1988, Lance E. Thomas (the "debtor") filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. Record at 44. On or about December 27, 1988, Curtis B. Danning was appointed the Chapter 7 trustee for the debtor's estate. Record at 44. Because the debtor failed to schedule any interest in the Club Drive property on his bankruptcy schedules, and no other realizable assets were disclosed, the Trustee filed his no-asset report. When the Trustee became aware of the estate's interest in the Club Drive property, he requested and the court directed the reopening of the case. Record at 335-36. Pursuant to that order, which was entered on August 7, 1989, the Trustee was reinstated in his capacity as Trustee. Record at 378.

Pursuant to a stipulation dated August 24, 1989 between the Trustee, Huber and Gunderson, and an order thereon, the Trustee sold the Club Drive property to an unrelated third party, and the interests of the Trustee, Huber and Gunderson attached to the net proceeds of that sale, subject to the costs of sale as defined therein, to

the same extent and with the same validity and priority that they had with respect to the Club Drive property. Record at 19. Pursuant to an order entered on January 7, 1991, the court fixed the costs of sale at $40,000, and those costs were ordered and have since been paid. Record at 19. Additional items have been paid from those funds pursuant to court order. As a result, the sale proceeds now aggregate approximately $162,000, including accrued interest (the "sale proceeds"). Record at 418 (as adjusted by subsequent accrued interest and expenses).

The Trustee commenced an adversary proceeding against Gunderson to avoid the Gunderson deeds (i.e. the unrecorded pre-petition deed and the unauthorized post-petition deed). Record at 19, 23. Pursuant to a summary judgment entered on December 28, 1990, the court avoided the Gunderson deeds and, pursuant to section 551, those transfers, including the recorded second Gunderson deed, were automatically preserved for the benefit of the estate. Record at 44, 389. That judgment, which is now final, also found that the Trustee held the Club Drive proceeds free and clear of Gunderson's interest. Record at 289-90.

It is also necessarily true that the Trustee held and holds the debtor's interests of all types, including his legal and equitable interests in and to the Club Drive property, as they existed on the date of bankruptcy. Section 541(a).

D. The Bankruptcy Court Ruling.

On or about September 25, 1990, Huber filed suit against the Trustee, the debtor[3] and Gunderson, among other things, to impose a constructive trust on the Club Drive proceeds. Record at 1-9. That proceeding was assigned adversary no. LA 90-02331-SB (the "adversary proceeding"). Record at 1. Pursuant to an order entered on December 13, 1990, the court dismissed Gunderson with prejudice from the adversary proceeding based upon a lack of jurisdiction. Record at 418. The Trustee responded to Huber's complaint and filed a counter-complaint requesting that the court avoid Huber's interest under section 544(a)(3) and/or that the court enter a declaratory judgment that the Trustee took free and clear of her interest. Record at 10-21.

On May 14, 1991, the Trustee filed his Motion for Summary Judgment on All Claims for Relief. Record at 30-71. After extensive briefing, the court granted the Trustee's summary judgment motion. Record at 406-09. That determination was based upon the Trustee's rights under section 544(a)(3), including the lack of constructive notice of Huber's alleged interest. Record at 414-20. On August 21, 1990, the court entered the judgment thereon, making appropriate findings of fact and conclusions of law.[4] Record at 406-20. On August 31, 1991, Huber filed

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[3] To the best of the Trustee's knowledge, the summons and complaint were never served on the debtor, and the claims therein against him have not been prosecuted.

[4] Unfortunately, although the Trustee submitted evidentiary objections to most of Huber's proffered evidence, Record at 266-69, 395-98, the court never ruled thereon. As a result, it will

her Notice of Appeal to the Bankruptcy Appellate Panel for the Ninth Circuit.

E. The Bankruptcy Appellate Panel Ruling.

On December 3, 1992, the Panel affirmed the bankruptcy court's entry of the summary judgment in the adversary proceeding, with one dissent. Record at 475-502. That decision was published at 147 B.R. 526 (Bankr. 9th Cir. 1992) and is attached as Huber's Appendix B. On January 4, 1993, Huber filed her Notice of Appeal from the Panel's opinion.

F. The Ninth Circuit Ruling.

On July 27, 1994, the Ninth Circuit Court of Appeals affirmed the Panel's affirmance in an unpublished opinion. Huber's Appendix A. On October 24, 1994, this Court docketed Huber's Petition.

II.

BASES TO DENY THE PETITION

The Petition should be denied because there are no special or important reasons in support thereof, as required by Supreme Court Rule 10.1. As discussed below, Huber has failed to cite to *any* federal appellate decisions concerning a trustee's "*bona fide* purchaser

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be assumed for purposes of the Petition that her evidence was considered.

avoidance power" under section 544(a)(3) contrary to that of the Ninth Circuit below.

Huber incorrectly cites to a split in authority among the circuit courts of appeal concerning whether section 541(d) excludes equitable interests avoided by a trustee under section 544(a)(3). Although she states that four (4) circuits courts have held contrary to the Ninth Circuit, a close reading of those cases clearly provides to the contrary. Each of those cases dealt with a trustee's powers under section 544(a)(1) or (2) relating to *personal property*, or was determined under the Bankruptcy Code as it existed before Congress enacted amendments in 1984 which clarified the matter. *Compare* 11 U.S.C.A. § 541(d) (1978) [Trustee's Appendix E] *with* 11 U.S.C.A. § 541(d) (1994) [Trustee's Appendix A].

As to her second issue, Huber contends that all three federal courts below misapplied California law on the rights of a *bona fide* purchaser for value. To the contrary, those courts acknowledged that California, before finding constructive notice to interfere with the rights of a *bona fide* purchaser for value, requires that one be in exclusive, open and notorious possession of the property. No such exclusive possession occurred here, because the debtor resided on the property at all relevant times. Moreover, Huber never challenged his occupancy.

Additional independent grounds exist to deny the Petition in this case. First, even if Huber otherwise were entitled to obtain the imposition of a constructive trust, California law clearly provides that a *bona fide* purchaser takes ahead of a constructive trust claimant. Second, Cal. Civil Code § 2950 (West 1994) [Trustee's Appendix F]

mandates that one may not offer evidence that a grant deed unconditional on its face should be reformed to reflect omitted conditions as against a *bona fide* purchaser, as Huber seeks. Third, the Trustee's successful avoidance and preservation of the Gunderson deeds creates an independent basis for the Trustee to take free of any constructive trust claim. For all of these reasons, the Court should deny the Petition.

III.

ARGUMENT

A. Section 544(a)(3) Is Not Inconsistent With Section 541(d)

1. The History of Section 541(d) Reflects the Defects in Huber's Claim.

The focal point of Huber's argument is section 541(d). However, that statute expressly limits only the debtor's property brought into the estate under section 541(a)(1) or (2). In contrast, avoidance power rights are brought into the estate pursuant to section 541(a)(3) and (4). Because this Court has repeatedly enunciated its position that the Bankruptcy Code is to be construed in accord with its express language, at least absent a statutory ambiguity, the Court need look no further to deny the Petition. *United States v. Ron Pair Enterprises, Inc.* (*In re Ron Pair Enterprises, Inc.*), 489 U.S. 235, 242, 109 S. Ct. 1026, 1031 (1989).

Huber conveniently omits any discussion of the amendments Congress passed to section 541(d). As it now reads, 541(d) serves to limit only that property brought

into the estate under section 541(a)(1) or (b). 11 U.S.C.A. § 541(d) (1994). The original statute did not express any such limitation, 11 U.S.C.A. § 541(d) (1978), because in 1984 Congress amended section 541(d). Pub. L. No. 98-353 (1984). Thus, Huber's reliance on cases wherein the bankruptcy petition was filed prior to 1984 is misplaced, as discussed below.

2. Section 541(d) Does Not Restrict a Trustee's Rights Under Section 544(a)(3).

Huber bases the Petition upon an alleged split in the circuits in interpreting section 541(d), contending that four (4) circuit courts have held contrary to the Ninth Circuit's decision below. Huber misreads the holdings in her characterization of those four cases.

Huber contends that the Fifth Circuit, in *Vineyard v. McKenzie* (*In re Quality Holstein Leasing*), 752 F.2d 1009, 1013 (5th Cir. 1985), held that "§ 541(d) overrides § 544(a)." Huber brief at p. 13. Instead, *Quality Holstein* held only that unperfected liens against certain aircraft which had not been impressed with a constructive trust prior to the bankruptcy filing would be subject to avoidance by the trustee under section 544(a)(1) and (2). *Id.* at 1013-14. Of course, that case involved personal property. Huber also failed to perfect any constructive trust claim prior to the debtor's bankruptcy filing. Record at 322. It is interesting to note that the Fifth Circuit came to this result even under the version of section 541(d) existing prior to 1984. Appendix E.

Huber also cites to *Sanyo Electric, Inc. v. Howard's Appliance Corp.* (*In re Howard's Appliance Corp.*), 874 F.2d

88 (2d Cir. 1989). However, that case involved air conditioners, which are also personal property. *Id.* at 90. Under section 544(a)(1), the court held that a constructive trust claim which was impressed prior to the bankruptcy filing prevailed against a hypothetical judgment lien creditor under New Jersey law. *Id.* at 95. As discussed below, a *bona fide* purchaser of real property in California takes ahead of a constructive trust claimant. In addition, Huber failed to perfect her constructive trust prior to the bankruptcy filing, as specifically required by *Sanyo*. *Id.* at 95.[5]

In *City National Bank v. General Coffee Corp.* (*In re General Coffee Corp.*), 828 F.2d 699 (11th Cir. 1987), *cert. denied*, 485 U.S. 1007, 108 S. Ct. 1470 (1988), the court held that a constructive trust claimant prevailed over the trustee's hypothetical judgment lien creditor powers for personal property (a pool of cash). *Id.* at 705-06. Perhaps most significantly, the court in *General Coffee* acknowledged but expressly did not resolve the issue, as it stated that the personal property in that case would be excluded either way. *Id.* However, the court specifically stated that under Florida law, a *bona fide* purchaser for value would take real property ahead of a constructive trust claimant.

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[5] The court in *Sanyo* criticized an earlier decision of the Ninth Circuit which it viewed in conflict with certain dicta on this subject contained in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 n.8, 103 S. Ct. 2309, 2313 n.8 (1983). *Sanyo*, 874 F.2d at 93 n.5. However, it should be noted that *Whiting Pools* arose under the old Bankruptcy Act, which was replaced by the Bankruptcy Code. One key change was to broaden the scope of property of the estate. *Compare* Bankruptcy Act § 709(b) [section 110(a)(b) of former title 11] *with* section 541(a).

Id. As discussed below, California law provides the same result.

The last case relied upon by Huber is *N.S. Garrott & Sons v. Union Planter National Bank* (*In re N.S. Garrott & Sons*), 772 F.2d 462 (8th Cir. 1985). However, that case also dealt with personal property (a fund of cash) and did not discuss section 544 at all. *Id.* at 465. Instead, the Trustee's attempt to bring in the property under section 541(a)(1) failed because of the exclusion under section 541(d) for equitable interests. *Id.* at 466-67. That case is entirely distinguishable. Thus, Huber's attempt to create a conflict among the circuits must fail.

3. The Ninth Circuit Cases are Not Inconsistent.

Although not necessary for any ruling from this Court, Huber contends that *Mitsui Manufacturers Bank v. Unicom Computer Corp.* (*Unicom Computer Corp.*), 13 F.3d 321 (9th Cir. 1994) is inconsistent with prior Ninth Circuit cases. Huber Brief at p.17. However, *Unicom* involved an attempt to recover personal property (a pool of cash) as a preference under section 547(a). *Id.* at 323. The court never discussed section 544(a), and likely would have come to the same result because of the trustee's lower priority under that section viz-a-viz constructive trust claimants for personal property.

Huber also argues that *National Bank of Alaska v. Erickson* (*In re Seaway Express Corp.*), 912 F.2d 1125 (9th Cir. 1990), was incorrectly decided. Huber Brief at p. 22. Huber instead argues for the principle stated in *In re Mill Concepts Corp.*, 123 B.R. 938 (Bankr. D. Mass. 1991). The

court in *Mill Concepts* ruled that, notwithstanding the express statutory language, a trustee's rights under section 544(a)(3) are limited to avoiding transfers and further limited by section 541(d) (i.e. that equitable interests like a constructive trust are removed from property of the estate). *Id.* at 941-42, 945-47.

As to the former issue, section 544(a) specifically provides that a trustee has "the rights and powers of, or may avoid any transfer . . . this is voidable by" a *bona fide* purchaser. Pursuant to section 102(5), "or" is not exclusive. A trustee is not limited to avoiding transfers under that statute. *Seaway Express*, 912 F.2d at 1129-30; *see Chbat v. Tleel* (*In re Tleel*), 876 F.2d 769, 771-72 (9th Cir. 1989).

B. The Trustee, As A Bona Fide Purchaser For Value Of The Club Drive Property From The Debtor As Of The Commencement Of The Case, Took Free And Clear Of Huber's Interest

The Trustee does not dispute that, outside of bankruptcy, a constructive trust is a remedy which a wronged party may seek; nor does he dispute that, outside of bankruptcy, the remedy of reformation is available where, as between the named grantor and grantee, a grant deed was intended to be for security purposes. However, "inside" of bankruptcy, the focus is on section 544(a)(3). This dispute is not between the grantor and grantee, but the grantor's creditors. California law is only relevant to determine what rights would be possessed by a *bona fide* purchaser for value of real property without actual notice of any defect.

1. A Bona Fide Purchaser in California Takes Ahead of an Alleged Constructive Trust Claimant

Huber's complaint filed in the underlying adversary proceeding asked that the bankruptcy court impose a constructive trust upon the proceeds of the sale of the Club Drive property based on alleged improprieties committed by the debtor. However, even if it is assumed that Huber's interest could have qualified for a constructive trust outside of bankruptcy, the Trustee, stepping into the shoes of a *bona fide* purchaser from the debtor of the property without knowledge of Huber's claim, takes free of Huber's alleged interests.

Under California law, a *bona fide* purchaser of the Club Drive property from the debtor on the date of bankruptcy would have taken title free and clear of Huber's alleged, unperfected and unresolved constructive trust on the house. *Rafftery v. Kirkpatrick*, 29 Cal. App. 2d 503, 507-08, 85 P. 2d 147, 150 (1938); *see Tleel*, 876 F.2d at 771-72. Huber admits that she executed and delivered a grant deed that, on its face, transferred all of her interest in the Club Drive property to the debtor prior to his bankruptcy filing. Thus, she gave Thomas legal title to the property. Perhaps more importantly, she empowered the debtor with the ability to sell that property to a *bona fide* purchaser for value. That *bona fide* purchaser would take free of Huber's alleged constructive trust claim. The Trustee, by operation of bankruptcy law, is such a *bona fide* purchaser. Section 544(a)(3).

2. The Facts Do Not Support Constructive Notice

As cited by Huber, the Ninth Circuit has held that, under California law, the rights of a *bona fide* purchaser, and hence the Trustee's rights based thereon, are subject to "constructive and inquiry notice." *E.g., Probasco v. Eads (In re Probasco)*, 839 F.2d 1352, 1354 (9th Cir. 1988); *Seaway Express*, 912 F.2d at 1129; *Tleel*, 876 F.2d at 773. Constructive notice requires tangible facts which would place a prudent purchaser on inquiry notice of the claims of another. *Probasco*, 839 F.2d at 1354. *In this case, however, there was no constructive or inquiry notice with which a* bona fide *purchaser for value would be charged.*

a. Huber's Occupancy Was Not Exclusive, Open or Notorious

Under California law, the burden of proof on the issue of constructive notice is on the party who claims that notice should be implied. *Wineberg v. Moore*, 194 F. Supp. 12, 17 (N.D. Cal. 1961); *High Fidelity Enterprises, Inc. v. Hull*, 210 Cal. App. 2d 279, 281, 26 Cal. Rptr. 654, 655-56 (1962). In a summary judgment proceeding, the burdens remain where they would be at trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252, 106 S. Ct. 2505, 2512 (1986).

In order for Huber to establish constructive notice based upon her possession of the premises, she would have to prove that her use and occupation was open, notorious, visible, and exclusive. *E.g., Claremont Terrace Homeowners' Association v. United States*, 146 Cal. App. 3d 398, 408, 198 Cal. Rptr. 216, 222 (1983); *Probasco*, 839 F.2d

at 1354-56; *High Fidelity*, 26 Cal. Rptr. at 655. Even setting aside the other necessary elements, Huber cannot prove that her use was exclusive, open or notorious.

Here, the Trustee does not dispute that Huber, her two daughters and her mother were living at the Club Drive property when the debtor filed his petition. However, it is equally undisputed that the debtor, as of the bankruptcy filing date, was also living in the premises. Hence, a potential buyer would have seen that the debtor's occupancy was consistent with his claim of ownership. Huber therefore fails to satisfy the requisite exclusive and notorious use requirements, and no constructive notice is to be imparted.

Many courts have determined that, when one holding title occupies property jointly with a stranger to title claiming an interest therein, the occupancy of the party in title does not provide constructive notice of his or her interest. *Rafftery*, 29 Cal. App. 2d at 506, 85 P. 2d at 149-50 (1938); *Campbell v. Grennan*, 13 Cal. App. 481, 483, 110 P. 156, 157 (1910); *Rankin v. Coar*, 46 N.J. Eq. 566, 22 A. 177, 178-79 (1890); *see Kane v. Huntley Financial*, 146 Cal. App. 3d 1092, 194 Cal. Rptr. 880 (1983). In those circumstances, the law regards possession as being with the title holder, and there is no presumption of an interest of the title holder inconsistent with the other joint occupant. *See Campbell*, 110 P. at 157; *Cameron v. Romele*, 53 Tex. 238, 244 (1880). This general rule is often applied when the joint occupants are related to one another. *See, e.g., Kirgan v. Kirgan*, 123 Mont. 34, 207 P. 2d 557 (1949). Most significantly, this general rule has also been applied where, as in the case at bar, the grantor is a joint occupant with the

grantee. *See Swanstrom v. Day*, 46 Misc. 311, 93 N.Y.S. 192, *aff'd without op.*, 101 App. Div. 609, 92 N.Y.S. 1147 (1905).

Huber cites to *Scheerer v. Cuddy*, 85 Cal. 270, 24 P. 713 (1890). There, the California Supreme Court specifically stated that the unrecorded interest (in that case a lease) was binding as between the parties to that writing, but not as against a third party *bona fide* purchaser. *Id.* at 714. However, Huber cannot claim that the unrecorded deed is not binding upon her as against the Trustee, who not only succeeds to the rights of the debtor – a party to that deed – but also has the rights of a *bona fide* purchaser.

More importantly, the *Cuddy* court specifically stated:

> 'The fact of *open, notorious, and exclusive possession and occupation* of lands *by a stranger to a vendor's title*, as of record, at the time of a purchase *from* and conveyance by *such a vendor out of possession*, is sufficient to put such purchaser upon inquiry as to the legal and equitable rights of the party so in possession, and such vendee is presumed to have purchased and taken a conveyance from the vendor with full notice of all the legal and equitable rights in the premises of such party in possession and in subordination to these rights . . . '

Id. (*quoting Pell v. McElroy*, 36 Cal. 268 (1868)) (emphasis added).

Huber is not within the rule stated in *Cuddy* because: (1) she did not have exclusive possession or make notorious use of the property, as the debtor himself (as well as others) were living there; (2) the debtor was not "out of possession" – he resided on the property at all relevant times; and (3) the debtor's presence with Huber's family

members was not inconsistent with the deed from Huber to the debtor when they were admittedly co-habitating in an extramarital relationship, and Huber was the grantor under the debtor's claim of ownership. Thus, *Cuddy* actually supports only *the Trustee's position.*

Huber also relies on *Evans v. Faught*, 231 Cal. App. 2d 698, 42 Cal. Rptr. 133 (1965). Huber summarizes that case as follows:

> a City's *exclusive occupancy* of part of a larger piece of raw land being sold, on which parcel the City had built a structure and a road pursuant to an unrecorded lease, put the buyer on inquiry notice of the City's interest, where the possession was 'open, *notorious, exclusive, adverse,* and not consistent with the record of title.'

Huber's Brief at p. 26 (*citing Evans*, 42 Cal. Rptr. at 137) (emphasis added). However, that case involved commercial property. Here there was no exclusive, notorious or adverse possession of even a portion of the property, which is a residential house, certainly not something as tangible as a separate building and road which the *Evans* court found to raise inquiry notice. Rather, Huber admits that her occupancy of the Club Drive property was not exclusive (because the debtor and Huber's family lived on the property at all relevant times). For that same reason, the use was not inconsistent with the legal title.

Huber also cites to *Robertson v. Peters* (*In re Weisman*), 5 F.3d 417 (9th Cir. 1993) to support her attempt to impart constructive notice. In *Weisman*, the Ninth Circuit found that constructive notice of the fact that others resided on the property without the debtor would bar a *bona fide*

purchaser from taking free of their interest under California law. *Id.* at 422. The Trustee agrees with that result, which is distinguishable because in the case at bar, at all relevant times the debtor also lived on the Club Drive property.

b. Locks on Bedroom Doors Cannot Constitute Inquiry Notice Which Would Interfere With The Trustee's Rights as a Bona Fide Purchaser

At the hearing on the motion for summary judgment, Huber offered evidence that certain family members resided with the debtor and her at the Club Drive property, and that their bedroom doors were at times locked. The Trustee has assumed only for purposes of the summary judgment motion and these appeals that these facts are true, but asserts that they fail to establish constructive notice of *Huber's* alleged interest.

Huber cites to *Probasco* for a case wherein this court found that there was constructive notice. *Probasco,* 839 F.2d at 1356. However, *Probasco* is clearly distinguishable. That case involved the issue of whether a third parcel of raw land was to be included on a deed with two other adjoining lots. *Id.* at 1353. There, a single fence around all three parcels, uninterrupted roadways connecting all three parcels, one subdivision map for all three parcels filed with the county clerk and construction occurring at the time on all three parcels was sufficient to constitute constructive notice that those lots were all owned by one owner. *Id.* However, our case concerns *residential* real property, with the debtor residing at all relevant times on

the premises. A third party would simply not have been put upon inquiry notice of any adverse claim, much less of an alleged contingency in an otherwise clear grant deed.

Huber fails to cite to *any* cases which find constructive notice from locks on doors inside a residential home. Rather, the California Supreme Court has stated that "the acts of dominion [necessary to constitute constructive notice] must be adapted to the particular land, its condition, locality, and appropriate use." *Gibbons v. Yosemite Lumber Co.*, 190 Cal. 168, 172, 211 P. 4, 5 (1922).

Here, the Trustee submits that it is clear that most or all residential homes (like the Club Drive property) have rooms which can be locked at appropriate times. Bedroom doors which may be locked, but admittedly were not at all times, clearly cannot rise to the level of constructive notice of an adverse interest. For if they did, where would the analysis end? Would it be sufficient that a bathroom door can be locked from the inside to maintain privacy? Or that a barn was not locked with a padlock, but could only be opened from one side? Does the court have to determine what kind of locks these were, and who had keys? Moreover, there is no evidence that the locks were visible from outside either the rooms or the house. In any event, what does a lock on a bedroom door give inquiry notice of? – certainly not that a grant deed should be a deed of trust! The triviality of the scenario reflects the inherent lack of substance to Huber's entire argument.

Huber has not claimed that any of her three family members had leasehold interests or any other interest in the property of which a third party would be on inquiry notice. Clearly, neither of the daughters nor the mother have claimed any interest in the Club Drive property or the proceeds thereof.

c. The Belief of Occupants of the Property Does Not Raise Constructive Notice to a Buyer

The belief of third parties residing on the premises as to the state of title does not raise constructive notice. The cases cited by Huber, as well as those addressed here, clearly provide that constructive notice is based upon objective facts which would put a third party on notice of another's claim (i.e. a third party tenant's residence on the property, fences around the land indicating joint ownership with adjacent parcels, etc.). Such is not the case here.

d. The Bankruptcy Documents Themselves Do Not Raise Constructive Notice of Huber's Alleged Interest

For the first time at the appellate court level, Huber argued that the bankruptcy documents themselves raise constructive notice of her purported interest. It should be noted that the schedules were not even offered before the bankruptcy court or made part of the record on appeal.

Aside from these procedural problems, Huber cites to *In re Professional Investment Properties of America v. Briggs*

(*In re Professional Investment Properties of America*), 955 F.2d 623 (9th Cir.), *cert. denied*, 113 S. Ct. 63 (1992) for the proposition that information disclosed in bankruptcy documents can raise constructive notice. However, in that case, the court ruled that specific disclosures in an involuntary petition could constitute constructive notice of an unrecorded deed of trust. *Id.* at 630. In Huber's case, however, the petition and schedules disclose no liens or interests in favor of Huber. Hence, no constructive notice could be derived from those documents.

Huber also cites to *Professional Investment Properties* for the proposition that "a diligent title search" would have revealed that she was the record owner. Huber Brief at p. 31. However, in the case at bar Thomas held a duly-executed (but unrecorded) grant deed from Huber to the Club Drive property on the bankruptcy date. Record at 45. His claim of ownership to the Club Drive property was entirely consistent with the subject deed, as was the fact that Huber was the record (c.f. legal) owner (as the subject deed was not recorded as of the bankruptcy date). These facts clearly distinguish this case from *Professional Investment Properties*. In addition, one must ask *of what* would either of these facts have given a *bona fide* purchaser constructive notice? Certainly not that the subject deed was intended to be for security purposes only. Hence, this new argument raised by Huber for the first time on appeal, and unsupported in the record, is devoid of merit.

3. Huber's Interest is Precisely the Type of Inchoate Claim that Section 544(a)(3) was Designed to Cut Off

It has been aptly stated that a constructive trust, which is what Huber seeks, "is an equitable remedy . . . designed to *equitably* distribute property or monies . . . " *In re Comstock Financial Services, Inc.*, 111 B.R. 849, 859 (Bankr. C.D. Cal. 1990) (emphasis in original). However, constructive trusts are "disfavored" in bankruptcy because they disrupt the equitable distribution of estate property to all creditors. *Torres v. Eastlick (In re North American Coin & Currency, Ltd.)*, 767 F.2d 1573, 1575 (9th Cir.), *op. modified*, 774 F.2d 1390 (1985), *cert. denied*, 475 U.S. 1083, 106 S. Ct. 1462 (1986); *Comstock*, 111 Bankr. at 859-60. In fact, the Ninth Circuit in *North American Coin* aptly stated:

> While we agree that any constructive trust that is given effect must be a creature of [state] law, we cannot accept the proposition that the bankruptcy estate is automatically deprived of any funds that state law might find subject to a constructive trust. We refuted that proposition in *In re Esgro, Inc.*, 645 F.2d 794, 797 (9th Cir. 1981) and *Elliott v. Bumb*, 356 F.2d 749, 753 (9th Cir.), *cert. denied*, 385 U.S. 829, 87 S. Ct. 67, 17 L.Ed.2d 66 (1966), where we held that, because of countervailing policies behind the Bankruptcy Act, state law could not be permitted to impose a trust on commingled property of a bankrupt's estate. A constructive trust is not the same kind of interest in property as a joint tenancy or a remainder. It is a remedy, flexibly fashioned in equity to provide relief where a

> balancing of interests in the context of a particular case seems to call for it. Moreover, in the case presented here it is an inchoate remedy; we are not dealing with property that a state court decree has in the past placed under a constructive trust. We necessarily act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors, for ratable distribution among all creditors is one of the strongest policies behind the bankruptcy laws. *See In re Visiting Home Services, Inc.*, 643 F.2d 1356, 1360 (9th Cir. 1981); *Hassen v. Jonas*, 373 F.2d 880, 881 (9th Cir. 1967).

North American Coin, 767 F.2d at 1575 (some citations omitted). Clearly, this sort of favoritism over other creditors is precisely what Huber seeks through a constructive trust.

Upon duly executing the grant deed to the debtor, Huber not only empowered him with the ability to convey that property to a *bona fide* purchaser for value, but also conveyed to him legal title to the Club Drive property. Upon his bankruptcy filing, the debtor in fact transferred that property by operation of law (section 541(a)) to a *bona fide* purchaser for value without actual knowledge of any defect – the Trustee. Section 544(a)(3). At that time, at the most Huber had a mere equitable interest in the property (i.e. a constructive trust claim). However, such unrecorded interests are avoidable under section 544(a)(3): "an asserted [i.e. non-judicially determined] constructive trust clearly represents the kind of inchoate claim that section 544(a)(3) was designed to cut off." *Tleel*, 876 F.2d at 773. Similarly, the Trustee submits that

Huber's interest is precisely the type of inchoate claim against property of the estate which section 544(a)(3) was designed to cut off.

C. The Post-Petition Recordation Of The Subject Deed And The Gunderson Deeds Divested Huber Of Any Legal Interest In The Property

Because the subject deed was recorded shortly after the bankruptcy filing, any defect in the Trustee's claim to the Club Drive property was cured.

In addition, it is undisputed that shortly after the recordation of the subject deed, the second Gunderson deed was recorded. Because the Trustee succeeded in avoiding the Gunderson deeds, section 551 automatically preserved that conveyance for the benefit of the estate. As discussed above, property brought into the estate under section 551 via section 541(a)(4) is *not* subject to the exclusion of equitable interests under section 541(d). This is an independent basis upon which the Trustee takes ahead of Huber.

Either way, any defect in title is cured by the recordation of the grant deed from Huber and/or the (avoided and preserved) grant deed(s) from the debtor to Gunderson.

D. Civil Code § 2950 Bars Huber From Claiming That Her Grant Deed To The Debtor Was Intended To Be A Deed Of Trust

Although it was not one of the legal theories relied upon by the bankruptcy court, the Trustee argued before

that trial court and both appellate courts, and now submits that California Civil Code § 2950 bars any judgment in favor of Huber. Trustee's Appendix F. That statute provides as follows:

> *Defeasance, to affect grant absolute on its face, must be recorded.* When a grant of real property purports to be an absolute conveyance, but is intended to be defeasible on the performance of certain conditions, such grant is not defeated or affected as against any person other than the grantee or his heirs or devisees, or persons having actual notice, unless an instrument of defeasance, duly executed and acknowledged, shall have been recorded in the office of the County Recorder of the county where the property is situated.

Thus, § 2950 is an entirely independent basis upon which this court may affirm the judgment.

The Trustee submits that § 2950 is the "missing link" in Huber's *bona fide* purchaser analysis. Specifically, although Huber argues that the recorded grant deed was intended only to secure her repayment of loans to the debtor, she relies instead upon cases that discuss whether physical facts lead to constructive notice of *unrecorded interests* (i.e. unrecorded leases, adverse possession, etc.). The grant deed at issue is absolute and clear on its face, and it is a *recorded interest*. Nevertheless, Huber requested that the bankruptcy court, in contravention of Civil Code § 2950, *inter alia*, make the grant deed conditional upon non-repayment of those loans.

Each of the three located cases which interprets § 2950 supports the Trustee's position. Although that

statute refers only to actual knowledge, and it is clear that the Trustee had no actual knowledge that the grant deed at issue was intended to be a deed of trust, one of the cases refers also to constructive notice. However, that case, *Brown v. Johnson*, 98 Cal. App. 3d 844, 159 Cal. Rptr. 675 (1979), held that recording a "notice of vendor's lien" could not provide constructive notice that a grant deed was intended to be a deed of trust. *Id.* at 678. *See also Duncan v. Ledig*, 90 Cal. App. 2d 7, 202 P. 2d 107 (1949) (grant deed would not be reformed to be deed of trust); *Rowley v. Davis*, 34 Cal. App. 184, 167 P. 162 (1917) (grant deed would not be reformed to be a deed of trust). Because the Trustee is not an heir or devisee, nor a person with actual knowledge of the alleged contingencies affecting the grant deed, section 2950 is an alternate basis for upholding the judgment in favor of the Trustee.

This statute is also precisely why the dissenting voice within the Panel's decision is legally incorrect. The entire argument raised by the dissent is based upon the proposition that in state court "Huber would be entitled to a hearing on her contention that the deed, while absolute on its face, was in fact a deed of trust and that she had a considerable equitable interest in the property." Huber Appendix B-40. Of course, that determination specifically is forbidden by Civil Code § 2950, which would bar Huber from offering any such evidence, even in a state court proceeding.

IV.

CONCLUSION

If, as Huber alleges, the debtor committed a fraud by advising her that the grant deed which she signed and delivered was merely a deed of trust, that is indeed unfortunate. However, Huber's remedy was to file a claim against this estate (which she has done) and, to the extent she believed appropriate, to file an action against the debtor to deem that claim nondischargeable. Sections 523, 727. However, the debtor's allegedly fraudulent acts are not a defense to the Trustee's rights under section 544(a)(3).

In the end analysis, Huber's problem is that she duly executed a grant deed in favor of the debtor concerning the Club Drive property and tendered that deed to him. As a result, Huber put the debtor in the position of being able to convey that property to a *bona fide* purchaser for value. In fact, by operation of law from the debtor's bankruptcy filing, the Trustee has now become that *bona fide* purchaser for value.

Locks on bedroom doors and co-occupancy with others not exclusive in the one claiming unrecorded rights in the property, cannot constitute constructive notice as against a *bona fide* purchaser for value in California. Nor can bankruptcy documents which are silent on the subject raise such a need to conduct an inquiry. As a result, Huber has failed to meet her burden of establishing that the Trustee was subject to any constructive notice of her alleged interest in the property. Huber's constructive trust claim must fail, and the Trustee must prevail.

The preserved conveyance to Gunderson also is by statute clear of equitable interests such as that asserted by Huber. In addition, Civil Code section 2950 specifically bars the relief which Huber requests.

The bankruptcy court properly resolved the issue at the trial court level, and entered the judgment. The Panel and the Ninth Circuit both affirmed. The Trustee respectfully requests that this Court deny the Petition.

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Respectfully submitted,

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APPENDIX A

§ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
>
> (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is –
>
> > (A) under the sole, equal, or joint management and control of the debtor; or
> >
> > (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
>
> (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.
>
> (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title. . . .
>
> . . .

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the

debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

APPENDIX B

§ 544. Trustee as lien creditor and as successor to certain creditors and purchasers.

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

APPENDIX C

§ 550. Liability of transferee of avoided transfer

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from –

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

APPENDIX D

§ 551. Automatic preservation of avoided transfer

Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

APPENDIX E

§ 541

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

APPENDIX F

§ 2950. Instrument of defeasance affecting grant in absolute form; necessity of recording

DEFEASANCE, TO AFFECT GRANT ABSOLUTE ON ITS FACE, MUST BE RECORDED. When a grant of real property purports to be an absolute conveyance, but is intended to be defeasible on the performance of certain conditions, such grant is not defeated or affected as against any person other than the grantee or his heirs or devisees, or persons having actual notice, unless an instrument of defeasance, duly executed and acknowledged, shall have been recorded in the office of the County Recorder of the county where the property is situated.